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Legal Alert

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Shared Construction of Residential and Other Properties - Finally a More Balanced Regime?

Federal Law No. 214-FZ *On Participation in Shared Construction of Apartment Blocks and Other Properties and On Amendments to Certain Legislative Acts of the Russian Federation* (the “Law”) has entered into force today, April 1 2005. The Law is significant in representing the first attempt to regulate relationships between developers and investors in one of the most dynamic sectors of the real estate market in Russia – the housing sector, utilizing various models of shared funding.

It would appear the Law is intended to regulate relations arising from multiple financing sources for the purpose of the shared construction of dwellings. The specific reference to “other” properties (from which “production facilities” are expressly excluded) would suggest that the Law also applies to the construction of office blocks, retail premises, and other commercial property, to which private investors are frequently attracted. Moscow and other cities across Russia are known to make extensive use of investment contracts which provide the means for the rehabilitation of existing commercial property and the construction of new projects. Clearly, the Law applies to all investment contracts in instances where funds are sourced from multiple investors and co-investors, and all participants in such contracts will now need to assess the implications of the Law.

The Law introduces direct-operation rules imperatively regulating relations between the property developer on the one hand, and the participants in shared construction arrangements on the other. The Law expressly defines the rights and obligations of the parties to a shared construction agreement, and includes such details as the amount of fines due for delays in payment, and delivery of the finished property. It also regulates in some detail a developer’s responsibilities to acquire the right to raise funds for a project, how such an agreement should be drafted (including with respect to the value and effective term), on what conditions it may be terminated, what quality guarantee procedures need to apply, and how such an agreement should be registered with the appropriate governmental authorities.

Prior to the enactment of the present Law, the rights of participants in shared construction arrangements have been largely unprotected; a situation made worse in the residential sector where developers have used strong consumer demand to impose their

own (often less than equitable) model agreements. It is to be hoped that the Law – clearly defining developers' obligations and the relations between developers and participants in shared constructions – may restore some balance to this situation.

The regulation of many provisions of shared construction agreements following the adoption of the Law is certain to augment the regulatory functions of the relevant governmental authorities in these matters. The Law includes, for example, a specific article defining the rights of the authorized executive agency in monitoring the financial operations of property developers, and also outlines the agency's other regulatory functions.

The Law will be instrumental in making relations between property developers and participants in shared construction more orderly and transparent. Enhanced liability on the part of property developers, joint and several liability of banks involved in project financing, and governmental registration of shared construction agreements should, collectively, promote the development of more equitable market relations in the longer term. At the same time, since (following the adoption of the Law) procedures for raising funds have become substantially more complicated, property developers may conclude that a more viable financing option is to secure funding directly from banks, rather than making use of shared funding schemes – with, potentially, a decrease in the number of new projects in this sector. In other developments, investors, developers and banks should (if correctly advised) be able to adapt to the regime imposed by the Law.

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